BEFORE THE

FEDERAL ENERGY REGULATORY COMMISSION

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IN THE MATTER OF: :

CONSENT MARKETS, TARIFFS AND RATES - ELECTRIC :

MISCELLANEOUS ITEMS :

CONSENT MARKETS, TARIFFS AND RATES - GAS :

CONSENT ENERGY PROJECTS - HYDRO :

CONSENT ENERGY PROJECTS - CERTIFICATES :

DISCUSSION ITEMS :

STRUCK ITEMS :

- -x

823RD COMMISSION MEETING

OPEN MEETING

Commission Meeting Room

Federal Energy Regulatory

Commission

888 First Street, N.E.

Washington, D.C.

Wednesday, March 26, 2003

11:10 a.m.

APPEARANCES:

COMMISSIONERS PRESENT:

CHAIRMAN PAT WOOD, III, Presiding

COMMISSIONER NORA MEAD BROWNELL

COMMISSIONER WILLIAM L. MASSEY

ALSO PRESENT:

DAVID HOFFMAN, Court Reporter

P R O C E E D I N G S

(11:10 a.m.)

CHAIRMAN WOOD: Good morning. This meeting of the Federal Energy Regulatory Commission will come to order to consider the matters which have been posted in accordance with the Government in the Sunshine Act for this time and place. Would you please join me in the pledge to the flag followed by a moment of silence for our men and women in Iraq.

(Pledge of Allegiance recited and moment of silence observed.)

CHAIRMAN WOOD: Thank you. We have a full plate today. We'll start, as we always do, with the Secretary. Madame Secretary.

SECRETARY SALAS: Good morning, Mr. Chairman, good morning Commissioners. Let me first note for the record that since the issuance of the Sunshine Notice on March 19th, the Commission voted to add the following items to today's agenda; E-23, E-24, E-25, and E-26.

The following items have been struck since the issuance of the Sunshine notice. E-7, E-22, G-1, G-2, G-3, G-27, G-28, C-1, C-2 and C-5.

Mr. Chairman and Commissioners, your consent agenda for this morning is as follows:

Electric items E-2, 3, 4, 5, 6, 8, 9, 10, 12, 14,

15, 16, and 20.

Gas items G-4, G-5, G-6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 17, 19, 21, 22, 23, 24, 25, 26, and 29.

Hydro items H-3, certificates C-3, C-4, and C-5 and C-6.

Again, the certificate items for the Consent Agenda are C-3, C-4, and C-6.

I note for the record that for E-16, Commissioner Brownell is dissenting in part and concurring in part with a separate statement. And Commissioner Massey votes first this morning.

COMMISSIONER MASSEY: Aye.

COMMISSIONER BROWNELL: Aye, noting the dissent on E-16.

CHAIRMAN WOOD: And aye.

I would like to before we depart from the consent point out there were a number of significant items that but for the other items on today's agenda we would have talked about but I would call those to the public's attention. E-10 Midwest ISO, we have moved the Midwest ISO closer to market operations in approving certain elements of its market monitoring plan.

E-12 we approved Dynegy's Intracorporate Reorganization.

In G-5 and G-6, we held in the case of first

impression on Caesar Oil Pipeline and Produce Oil Pipeline that are non-discriminatory open access mandate. Section five of the Outer Continental Shelf Land Act, an oil pipeline may operate as a contract carrier as opposed to a common carrier given the significance of the deep water gulf as a source of oil and the need for investment to access to that source.

And in G-26, Natural Gas Pipeline Company, we continued in our development of consistent policies regarding the balance of creditworthiness standards between the pipeline and its shipper customers by approving, with some modifications, the creditworthiness tariff language that was filed back in October.

We are also issuing certificates today to Energy West Development to convert a products pipeline in Montana and Wyoming to natural gas which I know will help to get that gas out of the basis and into the national grid, and to Egan Hub Partners to increase aggregate operating storage capacity at its Jennings storage facility in Louisiana.

So life goes on but we have an important item that we are looking at today, an important basket of items. I'd like to just start in a typical fashion with an opening statement here. Our remaining actions on today's agenda arise from the severe disruption that took place in the energy markets of the Western United States three years ago.

As noted by an earlier Commission, the markedly lower availability of hydropower that summer shifted significance reliance to natural gas-fired power generation, particularly in California, which had two years before revised its power market structure.

The increased natural gas demand was not easily handled by the natural gas infrastructure. The rules that governed the revised California market were not well-suited for supply constrained markets, and as we will lay out more fully today, this environment did allow certain market participants to take advantage of customers in both commodity markets.

Today we take up, as promised, the Big Four dockets related to events in the western power and gas markets of 2000 and 2001. A tremendous amount of work on market participants by our staff of administrative law judges has gotten us to this point today, and I'm grateful for the substantial effort made by all.

One basket of items that related to the El Paso Natural Gas Pipeline Company has been removed from our decisionmaking today. Last week, parties on both sides of the CPCU versus El Paso case requested that we postpone action today due to a settlement in principal that the parties have reached. Because the settled items in this case may affect a separate set of complaints regarding the

allocation of capacity on El Paso Pipeline and a certificate application to add new capacity to the pipe. These items have been struck as well.

Since the oral argument in CPUC versus El Paso in early December in this room, staff and Commissioners have been immersed in substantial review of this case. I want to particularly thank those who worked hard on the record including through the holiday season to put together an exceptionally clear and thorough analysis and an order.

The second of the items we will take up today is the Staff Report on its investigation into the Western Energy Markets. In that report, which we will hear next, a number of issues relating to gas and power markets were taken up in substantial detail. Staff has made 31 recommendations in that report for Commission action. We will discuss each of these recommendations. Some of those we will act on today; others will be taken up shortly.

A central conclusion of the Staff report is that markets for natural gas and power in California are closely tied together and that the dysfunction in each head off one another.

The first part of the Staff Report focuses on issues in the gas markets, particularly upon reliance on reported gas price indices to establish the appropriate mitigating market clearing price in the California Refund

Proceeding.

Concerned by the potential for these indices to be manipulated, Staff raised this issue in the interim report released in August of last year. The Commission, after that time, asked for public comments on the staff's recommendations. Based on further evidence uncovered during the Staff investigation and by other agencies investigating these issues that there has been manipulation.

Today we adopt a revised version of Staff's August recommendation to adjust the gas price methodology used in the California refund proceedings calculation of the mitigated market clearing price, while at the same time, allowing suppliers to be made whole for their actual gas purchases upon a showing to the Commission of their actual daily gas costs.

The Staff Report also, as directed, performed an extensive study on the correlation between spot markets and forward markets and concluded that there is a statistically significant linkage between spot prices and shorter term one-to-year contracts. The Staff report also reviews numerous other issues in the western power markets including the Enron strategies and the role of Enron's on-line trading platform.

Based on the study performed by the California Independent System Operator, a number of market

participants, both FERC-regulated and non-FERC-regulated, have been identified as having engaged in these strategies and entered into business relationships with Enron that raise concerns.

Under our current law, the Commission can seek disgorgement of profits in these cases provided that a violation of other than an existing tariff is shown. The Staff Report also identifies other potential past violations of tariffs. In addition to the Staff's investigation, a number of parties in the hundred-day discovery process initiated in November have identified many of the same events as well as other items. These were filed with the Commission of March 3rd, and responded to on March 20th.

As Staff will outline later, our review of this substantial volume of filings is not complete. We will not vote out enforcement orders on these issues until we can combine the issues raised in those pleadings with those being reported in today's Staff Report. The identified companies are listed in the Staff Report.

While our review continues, the Commission will be seeking immediate comment from parties on the tariff language that the Staff Report identified as being applicable to the potential violations. We will consider today draft show cause orders to revoke market-based rate authority for four power marketers; Enron Power Marketing,

Inc., Enron Energy Services, Inc., Reliant Energy Services, Inc., and BP Energy Company. We also consider show cause orders to terminate the gas marketing certificates for eight companies; Bridge Line Gas Marketing LLC, Citrus Trading Corporation, ENA, a company LLC; Enron Canada Corp., Enron Compression Services Company, Enron Energy Services, Inc., Enron MWLLC, and Enron North America Corp. We will get an update from Staff who have been diligently reviewing the voluminous record that came in this month from many parties during the hundred day discovery process.

We plan to follow up on some new physical withholding issues raised in that process. Separately, we will also post the Staff Analysis of the recent California Public Utility Commission Report on generator withholding. We will also, later this afternoon, make available to the public through our Internet website, the Staff report and the records of the Staff investigation in both rounds of the 100-day discovery process.

I should note that other agencies are also pursuing similar actions based on a similar set of facts and summing up the second item of the Big Four. I must thank Don Gelinas and Rich Armstrong and their many collaborators on the Staff team who have investigated this past year and dedicated their professional careers in the past 13 months to the investigation, analysis, and preparation in this

exhaustive report.

I also want to thank Jennifer Shepherd and her team here on Staff for their intensive review of the filings in the Hundred Day discovery process this past month. While much of the material was duplicative of Staff's findings, there are some new items we received and they are still reviewing those.

The third item on today's docket, I should say the third of the Big Four, is the California Refund Proceeding, which is based on Judge Birchman's findings issued last November based on the complaint filed in August of 2000. The Commission, in December of 2000, issued an extensive order deeming that the spot markets in the California PX and California ISO were dysfunctional.

Based on that order, the Commission, in July 2001, ordered that the clearing prices experienced during those dysfunctional markets, be mitigated to the levels that would have been experienced had a truly competitive market continued to operate. In the July 2001 Order, the Commission established a formula that would be used to calculate the mitigated market clearing price from the earliest possible refund effective date October 2nd, 2000 through June 21st of 2001, when a forward-looking mitigation plan became effective.

A version of that plan continues in effect today

across the entire western interconnection. The draft order on Judge Birchman's findings largely affirms his call on the host of issues that he addressed after the hearing last year. But substitute staff recommended gas price treatment for the spot gas price indices that were used to run the numbers at the hearing.

This issue raised by the Staff's interim report last August was subject to comment last fall, and today we conclude that it is appropriate to adjust the gas price proxy used to calculate the mitigated market clearing price while at the same time allowing suppliers to be made whole for the actual gas purchases upon a showing to the Commission of their actual gas costs.

This showing may be made by suppliers in the next 45 days and will be subject to an on-the-record review before the final refund determinations are finalized this summer. This action will increase the level of refunds from the level calculated by Judge Birchman in the hearing.

Our final series of cases today relate to a series of contracts entered into during the 2000-2001 time frame between suppliers and customers in the west. These include the October 2000 complaint by Puget Sound Energy relating to spot markets in the specific northwest which were the subject of an earlier referral to Judge Carman Cintron. A complaint regarding the term contracts between

Nevada Power, Sierra Pacific, Southern California Water Company and the Snohomish PUD against a number of sellers which was also handled by Judge Cintron.

In another complaint regarding long-term contracts between California Department of Water Resources and a number of sellers, which was handled by Judge Bobby Joe McCartney. We intend to discuss the interplay of these requests to abrogate contracts with the applicable standard of review for such actions, and with the Staff's report's finding of the correlation between the spot market dysfunction and short term contracts.

In addition to the orders we adopt today, there will be other orders and some follow-on proceedings to fully address these three groups of items. These will be handled in coming weeks.

I thank our very hard working staff for their contribution in analyzing and debating these very important issues over the past several months, and I thank them in advance for the work that remains. Bill and Nora, I know that we three are looking at these issues perhaps a bit differently but I appreciate the shared sense of seriousness and dedication to just outcomes that we bring to the table.

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We are all committed here to a timely resolution of all these issues based on the record and on the law.

Since our decisions will undoubtedly undergo judicial review, we are also committed to taking the necessary steps in collaboration with our sister regulators, public officials, and the industry to ensure that customers in all parts of the country never have to experience this sort of failure again.

I would like to ask Mr. Gelinas and Mr. Armstrong to proceed with our report on the Staff's investigation initiated in February of 2002.

SECRETARY SALAS: Mr. Chairman, I would note for the record that this item is E-18, Fact Finding Investigation and Professional Manipulating of Electric and Natural Gas Prices. Presentation by Don Gelinas, accompanied by Rich Armstrong.

CHAIRMAN WOOD: Let me ask before we do that if my colleagues want to add anything before we jump in for the day.

COMMISSIONER MASSEY: Chairman Wood, I have great respect for the leadership that you have brought to this Commission. You and Commissioner Brownell have approached all these complex issues with professionalism, integrity, intelligence and a sincere desire to do the right thing to ensure that justice is done and to see that the public interest is served. That doesn't mean that three of us agree on each and every policy call and detail, but we

certainly agree on much, as will be demonstrated today.

Today's meeting is bittersweet for me. No one needs reminding that I have served on this Commission for almost ten years and I have cast a number of votes related to the western electricity crisis. As a mea culpa, I confess that a number of years ago, I voted to approve the flawed California market design that became the breeding ground for the massive market failure that occurred during 2000-2001. It was a homegrown market design, overly and tragically reliant on last minute markets that could be easily gained. The blueprint was enacted by the State Legislature, championed by the Governor at the time. All pleaded for a regional deference which this agency provided.

I think that was mistake number one and was certainly understandable that the Commission would defer to a market design that seemed so popular in California. In retrospect, it was a mistake. Nonetheless mistake number two occurred early in the crisis. Power that had been offered for $30 per megawatt hour was now selling at $750 or even higher. Matters were quickly spinning out of control. Allegations of manipulation and price gouging abounded. It seemed clear that the market was dysfunctional, that prices were not just and reasonable, and I believe that we should have intervened forcefully early on to stop the economic carnage. This was not a market at work.

Fortunately, the Commission did finally act in June 2001 to provide full time price controls throughout the western markets. Yet by that point, severe economic pain and damage had been experienced. There's plenty of blame to go around for this crisis. And today's Staff Report will discuss in detail the role of market manipulation.

Yet, we must learn from the mistakes of the past so that history does not repeat itself. As Chairman Wood alluded to, this Agency must never again approve a market design that is so utterly flawed, even for the laudable goal of regional deference.

And if, despite our best efforts, a market spins out of control, we must forcefully intervene with price controls, if necessary. Market participants and state commissions are counting on this agency to carry out its statutory obligation to ensure that markets are well structured and functional, prices are just and reasonable and consumers protected.

But back to my story. The fallout continued. Long-term contracts at the extraordinarily high prices were negotiated during a crisis when it appeared that spot prices would rage out of control for a sustained period of time without relief. When the spot price is $500 or more, a long-term contract at $250 seemed like a pretty good deal. Yet, how is it possible to negotiate a just and reasonable

long-term contract when the benchmark for negotiations, the spot price is raging out of control with no ending in sight.

The Commission has explicitly recognized the correlation between spot prices and long-term prices in a number of Orders, and I understand that Mr. Gelinas will say more about that issue this morning.

At the outset, I said that today is bitter-sweet. I have discussed the bitter. The sweet is that under Chairman Wood's leadership, the Commission is coming to grips with this crisis. I think the Commission sent a very forceful message to Mr. Gelinas and his investigatory team to leave no stone unturned, to follow every lead, to follow each credible allegation to ground.

His report will spur a number of new proceedings to deal with the remedy, economic and physical withholding and credible findings of market manipulation and abuse.

The Commission is still reviewing the massive file that arose from the so-called 100 days of discovery proceeding. We will give serious attention to the evidence that discovery produced, and will take into account in effectuating remedies. The action we will take today to remedy economic -- we will actually take in the future to remedy economic withholding that occurred before October 2nd. This is particularly important, because it holds the promise of effective remedies for tariff violations occurring during the Summer and Fall of 2000, before the refund effective date.

The same is true with respect to credible allegations and findings of market manipulation or physical withholding. We will effectuate appropriate and meaningful remedies where we find such misconduct.

So I feel more confident that we are on the right road. I have great respect for the Gelinas report, for the work of his staff, for his recommendations. Thank you very much. We must continue to pursue these matters and effectuate appropriate remedies as soon as reasonably possible, so that consumers, market participants, state and local lawmakers, policymakers, can feel that economic justice has been done and can have more certainty about the future. Thank you, Mr. Chairman.

CHAIRMAN WOOD: Thank you, Bill. Nora?

COMMISSIONER BROWNELL: Bill, I have to say that we certainly appreciate the sense of history and experience that you've brought to the discussions, and certainly the Chairman's leadership, and, indeed, while you both acknowledge that we don't always approach these from the same perspective and we don't always agree on the answers, I think that the work of the Staff, which has informed us, and the work that we've done together, brings us a long way towards bringing some degree of finality to the issues that you've raised.

The issues before us today are difficult,

contentious, messy, and complicated. They are based on an enormous record that is often contradictory, very involved, and in some instances, based on allegations unsupported by fact and poor record keeping, not to mention that the record continues to grow and evolve and was largely developed significantly after the fact, with lots of hindsight and reinterpretation.

Further, the records are peppered with conclusions about behavior in the marketplace that assumes a market in equilibrium at all times. That's not true for any market at any time, and it is the furthest thing from the truth in the Western markets, starting in early 2000.

There is plenty of blame to go around, and I hope that the historians and consultants have a field day assigning that blame, but our job is different.

Our job is to hold market participants accountable to the law and to the record. Our job is not to do the politically correct thing, whatever that might be, and I certainly don't know what it is.

Rather, our job is to enforce the rules as they exist. Our job is not to arbitrarily apply rules retroactively; rather, our job is to design the rules that will protect future markets from chaos and the potential for abuse.

But, most importantly, our job is to assure that

customers are never again put at risk by a combination of dysfunctional markets, inconsistent and inadequate rules, insufficient and inadequate infrastructure, with market monitors who are unwilling or unable to act.

Customers are due justice; customers are due closure, customers are due a commitment to build for the future. And, indeed, while we had all hoped that today would bring complete closure and certainty, there are a number of tasks that continue before us, but I do believe that the combination of Orders that we are approving and Orders that will be forthcoming, do, in fact, go a long way toward providing the resolution for the past, and I encourage the parties not to be stuck on what they agree or disagree on with the past to the exclusion of developing the future.

We have learned lessons, we have learned that, in fact, there are imperfect markets. We have learned, I fear, that dysfunction breeds dysfunction, and the challenge before us in the 100-day discovery and the overwhelming amount of material we got in response to that, is to sort through what is a dysfunction that was based on intent to harm the market, what was the real effect on markets that were flawed, and what is, in fact, a dysfunctional response, which I know Don is going to talk about, in a dysfunctional marketplace?

So we do have very complicated work before us, but I think that today we have much that we can tell the customers who are owed the explanations that we have been waiting for. I look forward to working through the tough issues that will come, and I hope we can do so quickly and expeditiously.

You pointed out, Mr. Chairman, that, in fact, the rest of our agenda is moving forward, and I want to assure the rest of the world that it is. But I would like to devote as many resources as we can to working through these next issues quickly.

I think we owe it to ourselves. I think we owe it to the marketplace. I think we owe it to investors, and I think we owe it to other public policymakers. Thank you.

CHAIRMAN WOOD: Thank you both. With that, fellows, the carpet is wide and red, so walk on it.

MR. GELINAS: Mr. Chairman and Commissioners, good morning. As the lead of this investigation, I'm here today to brief you on our 13 months of inquiry into price manipulation in the Western Markets.

(Slide.)

MR. GELINAS: Our report, which will be made available today, is some 400 pages long.

(Slide.)

MR. GELINAS: As the Chairman noted, it has over

30 recommendations which are summarized in the last four pages of the Executive Summary. This morning, I'm going to try to go over some of the major findings and recommendations that we have offered for your consideration.

Our investigation has found evidence of manipulation of both the electricity and natural gas markets in the West, as those markets were inextricably interrelated.

We propose a series of both company-specific and generic remedies to address both the market flaws and the abuses that we found in our investigation.

(Slide.)

MR. GELINAS: Beginning with gas, our findings are that spot gas prices at the California border reflected extraordinary basis differentials that far exceeded the cost of transportation. The dysfunctions in the natural gas and electricity markets fed off of each other, but there was a critical misperception that the Topock delivery point was liquid, that, in fact, a single company's trading activity involving rapid-fire, high-volume trading, many times above its needs, singlehandedly led to an increase of about $8.50 per MmBtu in the critical month of December.

(Slide.)

MR. GELINAS: Market participants attempted to manipulate published indices, through what I can only

characterize as epidemic, false reporting and lack of internal controls.

Spot gas prices, quite frankly, were not the product of a well-functioning, competitive market. For that reason, we recommend, as the Chairman has discussed earlier, that spot gas prices for the California refund proceeding used in computing the market clearing price, be based on producing area costs plus transportation.

We estimate that this will reduce the cost of gas by about $7.00 per MmBtu in the North, about $4 in the South, for an average of about $5.50 per MmBtu. That said, many generators paid high spot gas prices. We also recommend, therefore, that they be able to recover their actual, verifiable invoiced daily gas costs, but on a dollar-for-dollar basis, not as part of the clearing price.

(Slide.)

MR. GELINAS: We have concluded that the Cal ISO and CAL PX tariffs on file have and do now contain anti-gaming provisions that identify various market abuses such as taking unfair advantage of market rules, excessive pricing or bidding, generally, behavior not consistent with a competitive market, and contemplate the imposition of sanctions and penalties by this Commission.

We concluded that many of the Enron trading strategies, various economic withholding and inflated

bidding patterns we have discovered, all violated the Cal ISO and Cal PX tariffs and the gaming provisions on file.

We recommended the issuance of a number of show-cause orders, some of which are before you this morning. One of our recommendations is that over 30 entities be directed to show cause why they're engaging in certain Enron strategies and Enron partnerships, did not constitute gaming or other anomalous behavior in violation of the Cal ISO and Cal PX tariffs, and why they should not disgorge any profits received from that misconduct from January 1st, 2000, forward.

The companies include AEP, Aquila, Avista, Coral, Dynegy, Enron, Idaho Power, LADWP, Mirant, PG&E, Pacificorp, Portland General, Powerex, Reliant, Sempra, Sierra Pacific, SoCal Edison and Williams.

We recommend also that Reliant Energy Services and BP Energy be directed to show cause why their market-based rate authority should not be revoked, in light of the apparent manipulation of electricity prices at the Palo Verde trading hub.

(Slide.)

MR. GELINAS: I believe we have an Order for your consideration on that recommendation.

We also recommended that Enron be directed to show cause, why its power market-based rate authority and

its gas blanket marketing certificate should not be revoked in light of their gaming and manipulation of gas prices and failure to disclose changes in their market share.

(Slide.)

MR. GELINAS: In the area of electricity, we recommend that certain sellers in the California spot markets be directed to show cause why their bidding behavior from May 2000 to October 2000, did not constitute economic withholding and inflated bidding with disgorgement of profits, all in violation of the Cal ISO and PX tariffs.

These companies are: Enron, BPA, Dynegy, Idaho Power, LADWP, Mirant, PowerEx, Reliant, and Williams.

(Slide.)

MR. GELINAS: With respect to long-term contracts, we conclude that market dysfunctions in the California short-term markets affected long-term contracts; that our analysis shows that spot power prices correlate fairly significantly, especially with long-term contracts of one to two years in duration.

We have concluded that spot prices in the Northwest during January to June of 2001 appear considerably out of line with input costs, and we recommend that our analyses in this regard be remanded to the ALJs to inform their proceedings in these matters.

(Slide.)

MR. GELINAS: In the area of generic recommendations, we recommend that Section 284 of the regulations be amended to provide for explicit guidelines or prohibitions for trading gas under blanket certificates.

We recommend that you consider a generic proceeding to develop appropriate reporting and monitoring requirements for sellers of natural gas under those blanket certificates.

We recommend that market-based rate authorities and natural gas certificates be conditioned on companies providing complete, accurate, and honest information to this Commission, to market monitors and to price indices.

(Slide.)

MR. GELINAS: We recommend that only actual trade data be used to construct price indices; that firms publishing the data sent to firms publishing these indices be provided by a risk management office, not part of a trading desk.

We're encouraging standard product definitions for both gas and electric price indices, and standard methods for calculating those indices.

(Slide.)

MR. GELINAS: We're recommending that a group of companies who have gone on record as having misreported prices, make certain demonstrations that they have either

ceased selling natural gas at wholesale, or they have taken appropriate measures and put in place, internal controls.

We recommend specific bans of any form of prearranged wash trading.

(Slide.)

MR. GELINAS: We recommend prohibiting affiliate trades to indices. We recommend conditioning blanket gas marketing certificates, as well as market-based rates for electric products so that sellers whose trading platforms use only those types of trading platforms, that agree to provide this Commission with full access to trade reporting and audit book information, and adhere to appropriate monitoring requirements.

Those are the key recommendations and findings. I'd like to take a minute to identify and thank my team.

(Slide.)

MR. GELINAS: John Delaware, my deputy, Rich Armstrong, Bill Booth, Bob Flanders, Dave Hunger, John Kroeger, Eugene Lee, Peter Simonyi, Tim Smith, and Marlene Stein.

They have my eternal thanks. They have my eternal respect. I've been in this Commission for 30 years, and I have never worked with a finer group in my entire career.

I also want to thank Valerie Messiet, who with

Grace and Resolve, has managed to always allow us to produce this report in all of its forms, in the most difficult timetables possible.

That's my presentation.

CHAIRMAN WOOD: Thank you, Don, for that, particularly for all the work that allowed you to distill that into a ten-minute presentation. I'd like to ask my colleagues if they have any questions, thoughts, or comments? Anything to add? Bill?

COMMISSIONER MASSEY: Don, would you give a little more thorough explanation of what you found with respect to the allegations of economic withholding that occurred earlier in the period of investigation, before the refund-effective date?

MR. GELINAS: Certainly, Commissioner. I'll let Rich, who primarily worked on that chapter, finish up. Generally speaking, from May to October of 2000, we discovered bidding patterns which were not at all reflective or related to cost inputs.

In fact, the correlation was absolutely inverse. As input costs rose and scarcity increased, bidding actually went down. What, in a nutshell, happened between May and October, was bidding that actually rode the price caps.

In May, when gas was somewhere in the #2 to $3 range, many companies were bidding the 750 cap. As gas

prices went up and the cap went down, they bid the $500 cap and as scarcity and costs were greatest in August and September, again, the bids were at the 250 cap, which was instituted in August. Rich?

MR. ARMSTRONG: Just to follow up on Don's remarks, our analysis looked at the market or was at a market level. And the report talks about economic withholding and high bidding. It doesn't address physical withholding.

On top of our analysis, the California parties came in with a more company-specific analysis of ten people, in-state generators and importers.

What our recommendation is, with the exception of one entity -- and that would be Duke -- that the Commission would institute proceedings for the remaining nine companies.

MR. GELINAS: Commissioner, that's it, in a nutshell.

COMMISSIONER MASSEY: That's very helpful, thank you.

COMMISSIONER BROWNELL: I had a couple of questions, and thank you for your hard work and your patience.

We asked you, fundamentally -- the initial charge was fundamentally to look at manipulation, perhaps consider

some of the other factors that were going on in the marketplace, but really to look at manipulation; is that correct? I just wanted to establish that.

MR. GELINAS: Absolutely.

COMMISSIONER BROWNELL: You talk a little bit about scarcity and some of the other things and don't get into any detail about the growth in the California marketplace that kind of picked up 1998, 1999, and the decline in capacity from 12 percent to five percent, something like that.

That really was not the focus. The focus was manipulation.

MR. GELINAS: Actually, Commissioner, I think it's fair to say -- and I tried to make it clear in the front of the Executive Summary, that, yes, our task was to see if short-term prices in both gas and electric were manipulated and if they affected long-term power prices.

But as Commissioner Massey said, I've been here for the whole ride myself, and we most certainly conclude that bad market rules and an imbalance of supply and demand made this fertile ground for the manipulation that we found. I think that without that, ample supply can cure many attempted manipulations.

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MR. ARMSTRONG: We have in our report the fact that during 1998 and '99, the average spot prices in California were approximately $29 and $31 respectively. So, with the same market rules in effect in that earlier period, something happened in 2000.

COMMISSIONER BROWNELL: A lot of things happened in 2000, as it turns out. My point was not that you ignored that, because you cover that in your executive summary. But the point is, it's very hard to put a weight on what affected what most, which is kind of where I'm struggling with that potential connection between the spot market and the short-term, and then longer-term marketplaces.

It's hard for me to get the correlation is causation or vice versa. But let me ask you this. We talk about churning quite a bit, and churning brings up lots of nasty little images. But one of the I think challenges for at least the marketplace largely was that the companies themselves were being evaluated on volume, not really revenues, so there's lots of kind of odd, perverse incentives out there to do behaviors that might otherwise look as if they were intending manipulation. Is that correct?

MR. GELINAS: I think that's correct. I think that's particularly correct in wash trading. I think that to the extent that there was a motivation there, it was to

be in the top ten list.

I think the trading that we found at Topock was just a function of an illiquid market with someone who in that illiquid market had such a huge presence that buying volumes way in excess of their needs moved the market price.

I think one of our conclusions is that gas markets can be thin. They're not all liquid at all times, as that is also true in electric. And so that premise that I went into this investigation with for my way of thinking has been disproven. And our recommendation is we need to find a way to monitor for when there is not sufficient liquidity so that a trading pattern that might otherwise be benign can cause harm to customers.

COMMISSIONER BROWNELL: And I think that was a point well made in your recommendations. Let me ask you about Frank Warlock's testimony on May 15th in 2002, where he really kind of reviews a number of standard arbitrage strategies that you see in many marketplaces, financial commodity and the energy market, and kind of concludes that most of these are appropriate strategies for businesses.

I guess where I'm struggling is as we move forward and try and marry up what you found in your report and the 100-day discovery and the response to the 100-day discovery, will we make some effort to kind of isolate the instances in a way that looks at the situation that we were

experiencing at that moment, and then additionally tries to make the connection between what real impact it had? Because I think his conclusions and others is the impact might not have been this great, or in some cases, it may have been in response to something that was happening in the marketplace that actually had a positive effect.

I'm thinking of the relationship perhaps between the chronic underscheduling of the incumbents and the response of the marketplace which was to overschedule. Is that what you're recommending in terms of kind of tying these things together?

MR. GELINAS: Yes. I think if you read the chapter on the Enron strategies, we try to fully explain all sides of the underscheduling by the California utilities. That was a cost saving strategy that spawned the Fat Boy strategy for Enron, where that had a counterbalancing effect.

We also described the ISO sort of being in the middle of that, and actually I think viewing Fat Boy as a workaround to a bad market role.

To get back to your earlier comment on the arbitrage, that would -- the discussion of the Get Shorty Enron strategy, which was to have a supply of ancillary services in the day ahead market and then buy yourself out of that in real time or on the hour ahead market, what we

were trying -- or what we do explain in the report is that in and of itself is an arbitrage.

What the Enron strategy was doing was having a fictitious resource in the day ahead and that is where the gaming comes in. And to the extent that you bought in the real time to cover your position, that is the only thing that we were recommending that the Commission go after, not a legitimate arbitrage.

COMMISSIONER BROWNELL: And I think you were careful to make that point, and I think we need to be careful to make that point as we move forward. Because it's going to be challenging, but I think our obligation to sort through what in fact was a legitimate response to a functional or dysfunctional market, what was a legitimate business opportunity and what in fact was an attempt at manipulation.

Then of course we've got to connect the dots to what the real impact was, as Professor Warlock, who Mike identifies, Chairman of the Market Surveillance Committee for the California ISO. So I think we've had a tough job, we have perhaps a tougher one going forward and making sure we can marry up that causation factor.

I will just say also before we move on, I'm glad that we're going to ask for comments on what may or may not have been tariff violations. My reading of the tariff is

somewhat different than my colleagues. I can't get that anomaly equals prohibition. Should have, perhaps, if history would suggest that we've learned anything. So I think we really need to also be focusing on that.

There are other questions, but you did a great job under trying circumstances, picky advisors who kept telling you there was always a better way to do something, and how many terabytes, Mr. Terabyte?

MR. GELINAS: Oh, a whole lot.

COMMISSIONER BROWNELL: Thank you.

CHAIRMAN WOOD: Thank you, Nora. One question I think certainly in reading the first four chapters which focus on gas that do have some critique of the current pricing system, was there any conclusion about there being a bias for the manipulation, a bias upward, a bias downward, or just that it was just not dependable?

MR. GELINAS: There were some of the false reporting that biased the book, but a book could be short or long. So, therefore, it could be on either side. Frankly, Mr. Chairman, the most difficult aspect of this has been our inability to get to the trade organizations who reported the indices so that we get behind the information and answer that question.

At this point, it could be on either side. We know that it's unreliable and not verifiable, but it could

be up, it could be down. The bias could be on either side. I do know that for the California market, a lot of the folks there sold at index. So if you wanted to attribute a bias, you might say they might have a bias upward, but then that would again depend on whether they were long or short. So there's absolutely no way for me to say which side it falls on. That would be just -- I'd be speculating. And there's enough speculation. We don't need any more.

CHAIRMAN WOOD: To hop to the end of the report, I don't really remember that it's come up in anybody's comments, but I know that we did an investigation of -- there was an allegation that Williams had attempted to corner the market that was carried in one of the papers. And we were actually -- we went in to check that. What did the staff find on that?

MR. GELINAS: Before I answer that, Mr. Chairman, I will say Williams was extremely cooperative. I want to get that out on the record. We were unable to substantiate those allegations whatsoever. And we devoted a short but I think fairly pointed chapter to that at the end of the report that in our view, Williams did not.

CHAIRMAN WOOD: And what effort did you go through to reach -- what investigative effort did you go through to reach that conclusion?

MR. GELINAS: In order to reach that conclusion,

we had to look at all of Williams' position and profit and loss statements for the relevant period to see what positions they had and what their physical needs were.

Quite frankly, they bought so little gas above their actual physical needs that the whole notion of someone cornering a market with buying a scintilla above their needs is pretty remote. That's the essence of the conclusion in Chapter 10.

Rich, did you want to add something?

MR. ARMSTRONG: Yes. Just that they roughly bought the gas that they needed to generate out there. We looked at their storage. They had storage that wasn't unusual, and the period of the allegation was during the worst months. It was towards the end of 2000, and that's where we concentrated our analysis.

CHAIRMAN WOOD: There's a lot in here and I guess the last month of my life has been lugging around this report. You've finally now copied it on two-sided paper.

(Laughter.)

CHAIRMAN WOOD: But when it was one-sided, it was a good little piece --

MR. GELINAS: I did that on purpose. I just had to make it difficult.

CHAIRMAN WOOD: My big picture take-away here, I mean, clearly the context -- and Don probably put it as good

as anybody -- it would have been hard to play these games if the infrastructure and the rules had been what we see in other parts of the country. But these games were played.

And I think it is part of our job to not only address the infrastructure issues which I should admit are not really being fully addressed in that part of the country, although I do think there's some incremental progress. But I think that it's due more to demand being down than supply being up. But I did see that the hydro reports actually ticked back up in the last week, so they're up from a low point.

COMMISSIONER BROWNELL: But that's God, not building.

CHAIRMAN WOOD: That's right. And the rules issue certainly is a big part of what we're talking about in that part of the country in particular. Status quo didn't deliver a good outcome two years ago, and I'm not sure that a lot has been changed. So I do think that while we do look, as we should, to the past and remedy as we can what happened, that the forward focus is still absolutely critical. And I do fear that but for another perfect storm, here we go again.

I do think that a lot of the recommendations -- we could go through them one by one, but I think Don captured them pretty well. There are a significant number

of what I call both backstop regulations, changes that we can make to certificates to our rules, to reporting requirements that are good policy in every market. And I do appreciate that you all have thought outside the box to think about how do we really make sure that these don't happen again.

So that is certainly a lot of work for us to do in the weeks ahead to do that, as well as the specific remedial actions that are contemplated here. I don't know if there's any particular items that you all want to talk about. I don't particularly need to focus on anything since I think we've hit them largely, but I do want to invite that if there's anything that Don hadn't hit or that we haven't talked about.

MR. GELINAS: I do think, on behalf of the team, that you hit the nail on the head. I think they're particularly proud with trying to not just propose remedial actions for individual behaviors, but to try to propose for your consideration some changes to our regulations, our rules, the way we monitor, that would have a constructive effect going forward, something we can build on.

And they spent a lot of time trying to produce something here that would be constructive going forward.

COMMISSIONER MASSEY: As I see it, Don, your report raises some specific allegations against specific

market participants with respect to very specific issues like economic withholding, and we will be pursuing that, like the Enron strategies, and we're going to be pursuing that through separate orders.

But you also take a look at generic market rules, tariff conditions for the future. And it seems to me the theory of that is, why don't we insist that all the rules are in place to make sure that the market is going to function well from the start? And of course, that's the whole point of the standard market design.

There's got to be a better way than two-year-old refund cases, all the allegations of abuse because the market could be abused, all the uncertainty that arises from that. Why not, why don't we just insist that the markets, both the natural gas markets -- and you make a lot of recommendations about the indices and what we ought to do there, which I respect. And I know we're having a proceeding. Has that been announced publicly?

MR. GELINAS: Yes it has. On the 24th.

(Laughter.)

COMMISSIONER MASSEY: Well, I'm here to announce it.

(Laughter.)

COMMISSIONER MASSEY: But good. It's been announced. On April 24th on the question of the reported

indices and what should be our policy on that. But it seems to me you deal with a lot of issues on, you know, how can we ensure that this doesn't happen again? What rules and structures do we need to put in place? What tariff conditions? What rules for behavior do we need to put in place to make sure that we're not in this mess again?

Because this is a hell of a way to do business. We have huge Commission resources devoted to fixing and making amends for a broken market, and we just can't go through this again.

MR. GELINAS: I certainly don't want to spend another 13 months at this again. And we sort of came to the conclusion that good rules, good information and timely monitoring could save us a lot of trouble going forward.

CHAIRMAN WOOD: I think to kind of wrap here, I do want to -- with some clarity for the outside world who is not looking at probably this document yet. The details of staff recommendations that are summarized in the Executive Summary are the 31. Did the number change from 31?

MR. GELINAS: I think that's about right.

CHAIRMAN WOOD: And I would like to say there are some specific action items here apart from the forward-looking fix the rules, amend the certificates type of proceedings that I would like to kind of lay out so it's clear.

The ninth recommendation is that we would require Dynegy, Aquila, AEP, El Paso Merchant, Williams, Reliant, Duke, Mirant, Coral, CMS and Sempra to demonstrate that they no longer sell natural gas at wholesale or that their employees, including trading desk heads and managers, who participated in manipulations or attempted manipulations of the published price indices have been disciplined;

That the company has a clear code of conduct in place for reporting price information;

That all trade data reporting is done by an entity within the company that does not have a financial interest in the published index (preferably the CRO); and

That the company is cooperating fully with any government agency investigating its past price reporting practices.

It's my intention to put before the full Commission an order that would incorporate that recommendation in the very near future.

On the 13th item, which is to conclude that the Cal ISO and Cal PX tariff anti-gaming and anomalous market behavior provisions identify various abuses and misconduct such as unfair taking advantage of market rules, excessive pricing or bidding and behavior not consistent with competitive markets, that these provisions authorize imposition of sanctions and penalties by the Commission,

that they are part of the rate schedules on file, and that the entities that engaged in them in the identified practices violated the Cal ISO and PX filed rate schedules, that we invite public comment on that issue since it informs some of the activities that we're looking at both here in the Gelinas investigation and that are raised by the 100-day evidence, and that a request for briefing on that will go out in the next day or so so that we have that information from parties.

On the following pages -- I'm going to quit counting the numbers -- and that is subsumed in the following three sets of proceedings. One would be to direct certain market participants identified in the January 6th, 2003 Cal ISO report, and those are listed in footnote 6, which I believe, Don, you did read those in? Is that correct?

MR. GELINAS: I read a good number of them.

CHAIRMAN WOOD: To show cause why the behavior did not constitute a violation of these tariff provisions. The second batch of items are the ten companies AES, Williams, Dynegy, Mirant, LADWP, Idaho Power, PowerEx, and Enron, to show cause why the prices from May to October 2000 did not constitute economic withholding or inflated bidding, in violation of the anti-gaming and anomalous market behavior provisions. That's related to the briefing, and, again, for the reasons that a number of these issues were raised in the 100-day discovery as well as here.

That we are continuing our review of both the claims and the responses to the claims. That may allow us to focus these proceedings, if we move forward, to be productive.

And then there is a third batch that's related back to that Cal PX - Cal ISO tariff provision, are the Enron trading strategies, which are really what we call the Enron business relationships, which are the companies across the Western Interconnect which are: Energy West, Montana Power, Puget, PowerEx, City of Redding, Colorado River Commission, Las Vegas Generation, Avista, Valley Electric Association, Public Service of New Mexico, Grant PUD, Gray's Harbor Paper Company, Modesto Irrigation District, and Tosco, will be the Enron business relationships to show

cause why they would not constitute gaming in violation of the tariffs.

In a moment, we will take up two of the recommendations, which are to show cause why a number of companies, including Enron, should not have their market-based rate authorization and blanket gas marketing certificates revoked, and, shortly thereafter, we do not have before us today, but I will put before the Commission, an Order for all jurisdictional entities to file any agreements with other entities that have characteristics of the Enron joint partnership agreements, so that they're not in violation of the statute and regulations.

Before us today, we will consider in a moment, after we're through here, the Reliant and BP Energy show-cause orders to show cause why their authority to sell power at market-based rates should not be revoked, based on activities alleged to have manipulated electric prices at the Palo Verde trading point.

We will take up in a moment, the recommendation dealing with the effects of the findings in this order on the proceedings in the Pacific Northwest that were subject to referral to Judge Cintron over a year ago.

And let's see, we have recommended to Congress about enhanced civil penalty authority. There is also a recommendation in here that Congress consider giving direct

authority to a federal agency, which could be the CFTC, or whoever, to ensure that electronic trading platforms for wholesale sales of electric power and natural gas are monitored and provided market information that's necessary for price discovery.

And I think that certainly the price discovery issues are a recurring theme here. And the rest of these, I believe, are forward-looking and will be taken up in proceedings that we will initiate in the coming weeks to amend our rules or to adopt other provisions on gas and power certificates, to basically backstop these issues, to make sure that we are fully and legally buttressed if that activity happens again.

Is there anything that I missed there?

COMMISSIONER BROWNELL: Just so I'm clear, this has been a tough week. We will adopt largely the recommendations, particularly those that are prospective. We will get comment on the tariff provisions and the interpretation of the tariff provisions as to what was prohibited and what was not.

We will then, against that comment, and including the 100-day discovery and the response to that, make some decisions on behaviors that we have identified in the past.

CHAIRMAN WOOD: Correct. That's the game plan.

COMMISSIONER MASSEY: May I just mention one

other issue? It's the issue of physical withholding, which I raised before. I'd like to characterize this appropriately.

I think that the Commission continues to pursue that question, whenever credible allegations arise. I don't want to disclose something here that will be inappropriate to disclose, but I'd like to say that I believe we will pursue any credible allegations of physical withholding and continue to take a look at that and continue to gather evidence on that.

CHAIRMAN WOOD: I should add in that regard that there were some issues in that regard raised in the 100-day evidence that we have not heretofore seen or taken up, and so we are pursuing that through the appropriate part of our Agency.

And that was not actually a part of this report, but is activity that we are taking care of in the other part of the Agency. So, thank you for bringing that up.

Okay, we have two Orders today, show causes that we do need to take up and so I would invite the Staff related to those to please come forward and lay those out for us. These were the late added items E-25 and E-26.

SECRETARY SALAS: Let me note for the record that this is E-25, Enron Power Marketing, Inc., and E-26, Reliant Energy Services. This is a joint presentation by

Larry Greenfield, accompanied by Joe Fina, and Ray Goodson, and Kent Carter.

MR. GREENFIELD: Good afternoon, Mr. Chairman and Commissioners. Hopefully there's a PowerPoint presentation with this. Good.

(Slide.)

MR. GREENFIELD: Before you today is E-25. There is an Order that would propose to revoke Enron's market-based rate and its blanket marketing certificate with respect to the electric side of the coin.

As Don has pointed out, based on the evidence collected and discussed in the Staff final report, it appears that Enron used the various so-called Enron trading strategies to game the market.

As a consequence of that, the draft Order before you is E-25, which would institute a show cause proceeding before the Commission that is a paper hearing, proposing revocation of their electric market-based rate authority.

Turning to the gas side of the coin, again, based on the data collected and the analysis contained in the Staff final report, it appears that Enron, again, has manipulated prices, in this case, gas prices at Henry Hub, and again, as with the electric side, the Order would institute a show cause proceeding before the Commission, i.e., a paper hearing that would propose revocation of their

gas blanket marketing certificate.

(Slide.)

MR. GREENFIELD: Turning to the second Order, E-26, that's an Order involving the proposed revocation of Reliant's and BP Energy's market-based rates. The report indicates that the -- the Staff's final report, that is -- indicates that there is evidence that Reliant and BP Energy appear to have manipulated electricity prices at the Palo Verde trading hub, and as a consequence, would institute a show cause proceeding before the Commission -- again, that's a paper hearing -- that would propose revocation of Reliant and BP Energy's electric market-based rate authority.

In this regard, I'd like to thank the folks who did work on these Orders. In particular, I'd like to thank Joe Fina, who is sitting to my immediate left, and Richard Howe, who is not here. Unfortunately, I neglected to put his name on the slide, for which, Richard, I owe you abject apologies.

In addition, I'd like to express my appreciation to Andre Goodson and Kent Carter, who are seated to my left and right, as well as Don Gelinas, Rich Armstrong, Marlene Stein, and Jennifer Shepherd, who all contributed to this effort. Thank you.

CHAIRMAN WOOD: Thank you, Larry. I just want to say that with regard to these two, in particular, I'm pretty

disappointed at this kind of activity, that this happens in our markets.

I guess I look forward to hearing what the excuse is, but my mind is still slightly open on this stuff, but this is not the activity that I associate with good old American commerce, not even from tough competitors on the edge.

This is activity that, as pled here, is highly disruptive to markets. It certainly violates some of the technical aspects of the law, but at its core, it's an assault on the spirit of the markets, and I do think it's incumbent on us to do up these things quickly and invite as much input as possible before making a decision.

But I am disappointed with what has been found.

COMMISSIONER BROWNELL: Maybe one or more members of the Staff can give a little description of what, exactly, was found, so that people who haven't seen this, understand what it is that we're commenting on.

MR. GREENFIELD: Let me, I suppose, take a crack at that. With respect to Enron, on the electric side, it basically had to do with the various Enron trading strategies that were outlined before, things such as the report highlights conduct such as the so-called ricochet or megawatt-laundering that was referred to earlier, the Get Shorty strategy that Rich Armstrong talked about earlier.

Those kinds of Enron trading strategies would have become known as the Enron trading strategies.

On the gas side, basically -- if I can take a quick look here. At the Henry Hub in Louisiana, they were, in a semi-complicated arrangement, trading off between the physical and the financial derivatives markets to run up the price for gas and then run it back down again to profit from that transaction or from those transactions.

I suspect Rich or Don can probably fill in a little bit more detail, but it was essentially driving up the price and then driving it back down through the use of Enron Online, their electronic trading platform.

With respect to Reliant and BP Energy, the situation was somewhat different. These were particular transactions that took place where BP Energy, at least the record seems to indicate the BP Energy trader got in touch with the Reliant trader to prearrange a series of transactions to drive the price up and then to buy it back.

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That is, they would drive the price up on the electronic platform -- in this case, it was the Bloomberg electronic platform -- and then off the platform in a private deal, they would arrange to undo the transaction. This happened, I think, either two or three times. I don't recall offhand.

But basically they were driving the price up, doing the transaction, and then immediately undoing it, which would allow in a mark-to-market accounting-driven industry, it would allow them to mark up the value of their portfolio, based on the high price that would appear on the platform.

But again, that transaction had been undone, off the trading platform.

COMMISSIONER BROWNELL: And in the latter situation, that's not speculation on our part; that's based on tapes of conversations where intent is clearly described by both parties.

MR. GREENFIELD: Yes, that's our reading of the evidence, yes.

COMMISSIONER BROWNELL: Thank you.

CHAIRMAN WOOD: Let's vote on the orders.

COMMISSIONER MASSEY: Aye.

COMMISSIONER BROWNELL: Aye.

CHAIRMAN WOOD: Aye.

Thank you all again. At this juncture, we would like to ask for a Staff update on the 100-day discovery review that was begun by an Order of the Commission in November, resulting in, I think, 103 days, due to a snowstorm-related extension that we granted on March the 3rd. It resulted in a number of filings coming into the

Commission, which were responded to last Thursday, whatever date that was, the 20th. So, thank you all for coming forward. Give us just an update on the process and what you're finding and what happened.

SECRETARY SALAS: Mr. Chairman and Commissioners, this is a presentation by Jason Stanek, who is accompanied today by Katherine Waldbauer, and Sanjeev Jagtiani.

MR. STANEK: Good morning, Mr. Chairman and Commissioners. March 3rd marked the end of the 100-day period where parties were permitted to adduce evidence that was either indicative or counterindicative of market manipulation that may have occurred during the California Energy crisis of 2000 and 2001.

Many parties, including the California parties, which is comprised of the people of the State of California, the Attorney General of the State of California, the California Electricity Oversight Board, the California Public Utilities Commission, Pacific Gas and Electric Company, and the Southern California Edison Company, as well as generators and sellers of electricity also made filings on March 3rd.

Commission Staff from the Office of Markets, Tariffs, and Rates; the Office of the General Counsel, and the Office of Market Oversight and Investigations, had jointly reviewed these voluminous filings during the past

three weeks.

The evidence submitted includes Enron memos, publicly-available GAO reports, press articles, a CPUC report on its wholesale electric generation investigation issued in last September, various Commission Orders, and initial decisions, and California ISO reports on Enron trading and scheduling practices.

Much of this evidence has been submitted in ongoing proceedings, and is currently publicly available.

I will now summarize the main arguments that were presented by the California parties and those contending that market manipulation occurred.

The California parties state that the prices in the spot markets operated by the Cal PX and the Cal ISO were unjust and unreasonable from October 2, 2000 to June 20, 2001, to the extent that they exceeded the mitigated market clearing price, otherwise known as MMCP.

They contend that prices in the ISO and PX spot prices before October 2, 2000, were not consistent with sellers market-based rate tariffs and those of the ISO and PX. They allege that sellers physically withheld from the market by placing units in reserve shutdown, declaring false outages, and not bidding operational units into the PX and ISO markets.

Many of the physical withholding events occurred

during ISO-declared system emergencies. They also allege that sellers economically withheld generation from the market by bidding high and in excess of its costs, so as to deliberately price themselves out of the market.

They contend that sellers participated in strategies, including Fat Boy, Ricochet, ancillary service games, uninstructed generation congestion games, and they also allege that sellers shared non-public generation outage information.

The parties also claim that natural gas border priced indices currently used in the refund calculations pursuant to the July 25th refund Order, were manipulated and not reliable or appropriate for use in this proceeding. They request that the Energy Exchange transactions be subject to refund and sales greater than 24 hours be subject to refund.

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Accordingly, indicative of a number of parties, the California parties state, quote: Given the totality of the wrongful conduct involved, it is not possible to isolate the harmful effects of any one violation or any one bad actor. The Commission therefore should:

1. Reduce the market clearing price in the ISO and PX spot markets to the MMCP cap for the period from May 2000 through June 20, 2001.

2. Apply that price to all spot market sales in the ISO and PX, even if the seller was able to coerce the ISO into out-of-market sales, as long as one month or into energy exchanges rather than sales for cash; and

3. Apply prices to all short-term sales to the California Energy Resource Scheduler, otherwise known as CERS, that was filling the role originally filled by the PX or responding to sellers' refusal to sell to the ISO.

Similarly, Pacific Northwest Municipals argue that the Western Electric Coordinating Council is one market, and to support its claim the WECC is a single market, they provide models of spot prices in California and the West and found that a high correlation of prices among the trading hubs. They also contend that the prices in a number of the long-term contracts were based on spot prices.

The generators came back, the opposing camp, and

the generators and sellers into the Western markets, argued to the contrary. In their filings, the generators made three primary arguments in support of their claim that they did not engage in any abuse of market power that would have resulted in a material effect on wholesale prices in California and the West.

First, the generators contend that the high prices and price volatility in California's spot markets were the result of high demand coupled with a significant loss of supply.

Second, the generators contend that during the period under consideration the vast majority of price variations in the Western markets can be explained by fundamental economic factors.

The generators contend that it was not market manipulation but fundamental factors that were largely responsible for the adverse market conditions. Such factors include:

Abnormally hot weather conditions resulting in increased demand;

A high level of planned and forced outages resulting in as much as 7,500 megawatts offline;

The expanding tech economy out West which caused electricity demand to exceed historic peak levels and all reasonable forecasts;

Increased electricity demand for pollution credits at significantly increased costs.

Similarly, emissions credits on many thermal units prevented them from operating more than a certain number of hours per year. There was also increased credit risk associated with PG&E and So Cal Edison's ability to pay for energy purchases, and this undermined the creditworthiness of the ISO and PX markets, which had the resulting effect of decreasing supply and increasing prices.

They also point to the fact that no significant generation had been added to California in recent years. There was inadequate transmission capacity for existing infrastructure. There was a doubling of natural gas prices coupled with the increased reliance on gas-fired units. There was also significant reduction of imports in energy from the Pacific Northwest.

Lastly, they claim that the industrial owned utilities failed to make payments to qualified facilities,thereby reducing the available energy supplied by nonutility generators.

On the other hand, the generators also argued that California's market design was ill-conceived, and that the state's attempt to restructure the energy industry was a failure. The generators note that structural design flaws helped push the price of electricity in the California

markets during the crisis.

The flaws the generators cite include a bidding structure where buyers attempted to reduce their average price by underscheduling in the day ahead market and shifting their purchases to real time; a retail rate freeze which provided consumers with no incentive to decrease demand. Additionally, the state didn't encourage any voluntary conservation until blackouts occurred.

And the generators also contend that the state's restructuring required IOUs to divest almost half of their generation and to buy and sell power almost exclusively through the Cal PX spot markets. This prevented the utilities, they say, from hedging their risk by developing a portfolio of short-term and long-term products.

Last week on March 20th, approximately 90 parties filed rebuttal. They consist of power suppliers, public utility districts, irrigation districts, as well as many of the parties that submitted evidence earlier on March 3rd. The responsive pleadings contained at least twice as much material as was submitted in the March 3rd initial filing.

In rebuttal, many sellers presented evidence specific to their particular conduct which such sellers allege show that they did not seek to manipulate the market. As such, the bulk of the rebuttals address allegations that have been raised previously.

For example, with regard to allegations that sellers scheduled export transactions in the day ahead market and then scheduled import transactions in the same energy in real time, several sellers noted that they were continually buying and selling energy on a daily basis to keep up with the volatility of their loads needs. Therefore, it is not surprising that this might lead to buying and reselling or selling and then repurchasing the same energy from one day to the next.

Given the large volume of material received on March 3rd and March 20th, it will clearly require some more time for Commission Staff to evaluate all this material and determine what should be directed into upcoming and ongoing proceedings.

For example, California parties and others provided extensive examples of transactions and other behavior which they allege to be affirmative market manipulations. Moreover, a great deal of data was submitted to show that in some cases, generators deliberately caused outages.

Generators, however, have provided alternative explanations to support their positions that the transactions were legitimate. Therefore, we are committed to carefully evaluating all the material submitted.

Mr. Chairman, as you noted, the bulk of the

evidence from the 100 days filing will be made available to the public electronically via a dedicated Web server at 5:00 p.m. today. And we want to thank the docket staff and the Office of the Secretary for their efforts.

Our team would also like to thank Jennifer Shepherd, who served as our team leader but unfortunately was not able to be here today.

Thank you. This concludes my presentation.

CHAIRMAN WOOD: Jason, thank you. And thank your folks. I know you all have kind of disappeared down into the bowels for the last month, so the sun is out, but the work isn't done. And I appreciate your honest assessment of the substance and the volume. And it's I think, to build on the Nora's earlier comment, it is incumbent on us to really weigh it and evaluate it so we don't park any of the further proceedings that may come out of this into some open-ended proceeding that goes on for months on end; that we give it some up-front focus from the Commission.

So I appreciate your efforts and those of all the other folks who will be working in the next month to pull that all together.

Questions for the team?

(No response.)

CHAIRMAN WOOD: Thank you very much.

COMMISSIONER BROWNELL: Just a thank you. Not

only was that a great presentation, but I think you've begun to do the work of sorting through a voluminous amount of information, but determining what's new and what's not new I think has been a great service to everyone. I'm grateful. We hope Jennifer is having a good time in London, and for the team it's spring outside, and it might be summer by the time you're through, but we'll keep you posted.

(Laughter.)

COMMISSIONER MASSEY: There's obviously some overlap in the evidence between that disclosed by the so-called 100 days of discovery and that disclosed by the Gelinas report. The litigants, market participants, did not know what the Gelinas report would deal with, so there is definitely a fair amount of overlap and some new stuff too.

So thank you very much.

SECRETARY SALAS: Mr. Chairman and Commissioners, the next item in the discussion agenda this morning --

CHAIRMAN WOOD: Why don't we take, for the Court Reporter and others, why don't we take a little bit of a break? Just two minutes.

(Recess.)

CHAIRMAN WOOD: Madam Secretary?

CHAIRMAN WOOD: Yes. Mr. Chairman and Commissioners, the next item in your discussion agenda is E-17. This is San Diego Gas & Electric Company, and this is a

presentation by Leonard Tao.

MR. TAO: Good afternoon, Chairman, Commissioners. E-17 is an order that addresses proposed findings by the Presiding Administrative Law Judge in this proceeding concerning refunds for California for purchases made in its organized spot markets from October 2nd, 2000 through June 20th, 2001.

In past orders, the Commission found serious flaws in the electric market structure and market rules for wholesale sales of electricity in California, and that these market structure problems, in conjunction with an imbalance of supply and demand, caused unjust and unreasonable rates.

The Commission initiated formal evidentiary hearings in these proceedings to further develop the record regarding the implementation of the Commission's mitigated market clearing price methodology and a determination of a refund amount for the 8.5-month refund period.

In December 2002, following the establishment of an extensive hearing record involving more than 100 active parties, the Presiding Judge issued proposed findings that suppliers owe the California Independent System Operator and the California Power Exchange an estimated total of $1.8 billion in refunds.

Because of the outstanding balance owed to suppliers is currently $3 billion for electricity delivered

but unpaid over the refund period, the Presiding Judge calculated that the new balance owed to suppliers is approximately $1.2 billion.

Today's order makes several significant findings. Central to the determination of a refund amount, the order adopts a new proxy that is designed to replicate as best as possible competitively derived spot gas prices used in the computation of the mitigated market clearing price. This proxy relies on producing area prices plus an allowance for transportation costs.

In addition, the order allows generators to recover certain gas costs for spot gas purchases during the refund period. This proxy method strikes a balance between protecting customers from prices based on market manipulation and protecting suppliers' incentives to compete in the California energy market.

Through thus proxy method, the calculation of mitigated market clearing prices will yield just and reasonable prices for customers that used California's single clearing price auction during the refund period. Based on Staff estimates, we believe that Californians will receive a net refund after deducting the current balance owed to suppliers.

As dictated by the applicable federal regulations, request for rehearing concerning the issues in

this order are due 30 days from the issuance date of this order. Accordingly, in this order, the order defers the settlements and billing process to calculate a final refund amount until after the Commission makes a final decision.

Finally, I must thank several people who made significant and important contributions to the completion of this order. First and foremost, Rahim Amerkhail, who is enjoying probably at this minute a very nice dinner on the River Thames in London with his wife Jennifer. Shahab al Sakam, J.B. Shipley, Shar McWayne, and of course the remarkable team of Don Gelinas, Rich Armstrong and also Bob Flanders.

Thank you.

COMMISSIONER MASSEY: Go ahead. I'll defer to the two of you for just a minute.

CHAIRMAN WOOD: The process for getting the information for determination of the actual costs, how will that step out?

MR. TAO: We will review any comments and requests for rehearing of the issues. Once those due process concerns have been addressed and we've addressed all of the relevant comments and made any changes at that point that are necessary, we can -- I suppose we have a few options. We can, like the judge, as the judge did, we can direct the Cal ISO and the PX to rerun their settlements and

billing processes to come up with a number. It's possible we could hire an outside agent to run those numbers. I guess it's a call we'll have to make down the line.

But as soon as we can focus in on getting some of these issues finally settled, we'll be ready to go with running those numbers into those formulas.

CHAIRMAN WOOD: As to the offset issue, which is defined as the difference between what the market clearing price is used, what gas input is used for the market clearing price, and what's the price that was actually paid by the suppliers? How is that process going to work?

MR. TAO: Specifically, how are the individual generators going to -- regarding the cost allowance issue?

CHAIRMAN WOOD: Correct.

MR. TAO: Okay.

CHAIRMAN WOOD: Is that deferred until after rehearing too, or can we get started on that?

MR. TAO: That will have to wait until after rehearing. As it currently stands, we would have each of the generators in the order of the short-term spot gas sales that they have in their portfolios submit records of their actual costs. They will have to sequentially put in those gas costs up to the amount, each of those transactions up to the amount that they spent on those spot gas sales -- purchases, I should say.

And this will ensure that the fuel cost allowance that we're returning back to the generators is specifically for those spot gas purchases by those generators.

CHAIRMAN WOOD: Can we go ahead -- I don't think that it's dependent upon the ISO rerunning the data to go ahead and get that account information back in here so we can not extend this --

MS. MARLETTE: Right. I mean, we had talked about the possibility of giving them 45 days to come in with their information. I don't know, Lynn, if that would interfere in the event the Commission were to change its mind on rehearing. But I don't think that's likely.

So one option would be that you could go ahead and get the information in. It's not reflected in the order right now.

CHAIRMAN WOOD: Let's get on with that. Why don't we fix that order and maybe get that fixed this afternoon and put that out so we can get going on that aspect of the calculation? Because I think the rest is kind of laid forth how that's supposed to be done.

MR. LARCAMP: I think all you probably need is a brief ordering paragraph, because I think the substance is in the order itself.

MS. MARLETTE: Right. So you can just vote subject to us putting that in.

CHAIRMAN WOOD: Okay. Which would say 45 days to be followed by a technical conference?

MS. MARLETTE: If you'd like, we could do that.

CHAIRMAN WOOD: Yes. Why don't we give another -- 40 and 20, and then we can get this up here by the end of May.

MS. MARLETTE: Okay.

CHAIRMAN WOOD: Anything else?

COMMISSIONER MASSEY: When we sent this matter to Judge Birchman in our July 25, 2001 order, there were two aspects of it that I disagreed with at the time and wrote a separate dissent on.

One of these matters on the issue of nonjurisdictional entities, then-Commissioner Breathitt joined me on. And one of the aspects is whether we can extend the refund obligation to nonpublic utilities that are otherwise nonjurisdictional. And my position in July of 2001 was that we could not.

I understand the rationale for the order. It has a strong visceral appeal as a matter of equity. But I am concerned about the jurisdictional question, and I still have not reached the conclusion that we have this authority.

The second part is the inclusion of the 10 percent creditworthiness adder in determining the mitigated market clearing price for refunds. And I said at the time

that I disagreed with including that adder. My position remains the same; that the adder is not necessary and the formula should be adjusted accordingly.

In other respects, I agree with this order. I agree with the changes that we are making in determining the gas price inputs into the market clearing price, and I agree to the changes that we're making that take into account the Gelinas report.

COMMISSIONER BROWNELL: I'm asking this question as a clarifying one for the people in California who heard discussion of refunds and expect they will get a check in the mail. Where will the refunds go?

MR. TAO: The refunds would be owed to the Cal ISO and the PX.

CHAIRMAN WOOD: And the offsetting $3 billion is largely in the PX as collateral, and in the bankruptcy suit with PG&E, or is that coming from somewhere else? Did the Judge mentioned it here?

MR. TAO: I don't recall specifically how he read that out.

CHAIRMAN WOOD: The offset for the number that was bandied about here is actually sequestered in other places. It doesn't end up coming out that's not already been paid. There's a lot in this case. I tip my hat to the Judge. I guess I was one of the impatient souls wondering where this case, and of course I found out when you read the voluminous comments on the Judge's findings, pro and con, it's no secret why this took as long as it did. I therefore apologize for my kicking the wall about how long this took. It's appropriate to do this right. I think it is wise. Let's get the rehearings in before we ask the ISO to re-run all the data so we just have it one more time, because I know that's a significant effort, and quite frankly, we need

to keep the lights on and the power lines up, as well as help us clean up the historical issues here.

So I could have gone different ways on different stuff, but I do think at this stage, it's appropriate here. The actions we take in this order and I appreciate the give-and-take we've had over the past several weeks, grappling with this particular initial decision. I think we hit the right balance here, so I will support it. Let's vote.

COMMISSIONER MASSEY: For the reasons I just mentioned, no, in part.

COMMISSIONER BROWNELL: Aye.

CHAIRMAN WOOD: Aye.

SECRETARY SALAS: The final item in the discussion agenda this morning is a joint presentation of E-21 Puget Sound Energy, E-23 California Public Utilities Commission, and E-24, Nevada Power Company. This is a joint presentation by Mike Bardee. He's accompanied by Jonathan First and Olga Kolotushkina.

MR. BARDEE: Good afternoon. Pending before the Commission are three initial decisions on complaints seeking to modify long-term contracts for wholesale power signed during the western energy crisis. The first case is E-24, the Nevada Power Case, in which complaints seek to modify over 200 contracts entered into with ten sellers.

The second case is E-23, the California case, in

which complainants seek to modify over 30 contracts entered into with 23 sellers.

The third case is PacifiCorp, Docket Number EL01-80 in which the complaint seeks to modify 12 contracts with four sellers.

Briefing by the parties is not concluded in the PacifiCorp case so the rest of my remarks do not address that case.

E-23 and -24 were set for hearing to determine whether the dysfunctional markets were under the California ISO and PX adversely affected the long-term bilateral markets and if so, whether the effect was of magnitude warranting a magnification of the long-term contracts. In addition, for those contracts that did not have an explicit Mobil Sierra Clause, an issue set for hearing was whether the complainants must meet the Mobil Sierra public interest standard of review or the lower just and reasonable standard of review.

In the Nevada Power Case, the ALJ found that the Mobil Sierra public interest standard of review applies to the contracts at issue, and that complainants failed to establish that the dysfunctions of the CAL-ISO and PX spot markets adversely affected the long-term bilateral markets. The ALJ therefore concluded that the contracts at issue should not be modified.

In the California case, the ALJ found that the Mobil Sierra public interest standard of review applies, and as instructed by the Commission, certified the record of the case directly to the Commission for consideration of all other issues.

In E-21, an ALJ issued recommendations and proposed findings of fact on a complaint filed by Puget Sound. Puget asked the Commission to cap the prices at which jurisdictional sellers could sell power into the Pacific Northwest wholesale spot power markets.

Although the Commission additionally dismissed Puget's complaint, on further consideration, the Commission directed the ALJ to develop a record on whether there may have been unjust and unreasonable charges for spot market bilateral sales in the Pacific Northwest from December 25th, 2000, through June 20, 2001.

The ALJ concluded that claimants had failed to establish that the prices in the region were unjust and unreasonable. The ALJ stated that the record did not support allegations of market manipulation. The ALJ also noted that the claimants had not established under the Mobil Sierra public interest standard that the contracts should be modified and that further proceedings ordered in this case. The applicability of the Mobil Sierra doctrine, to the specific claims against bilateral transactions would have to

be determined.

Staff's final report on its investigation, as discussed earlier, finds that during the period January 1, 2000 through June 30, 2001, there was a particularly significant relationship between spot and forward power prices in the west. The report finds that spot price distortions flowed through to forward power prices, particularly for contracts with one-to-two year terms. Staff recommended that for contracts subject to a just and reasonable standard of review in the long-term contract cases, the Commission should send Staff's analysis to the ALJs to uses as seen fit to resolve the complaints.

Staff has analyzed the Mobil Sierra issue for the purposes of E-21, -23 and -24. Staff recommends defining the public interest standard as follows: Complainants would need to show that the contract prices are so high as to threaten a buying utility's ability to maintain reliable service for its customers or to cause significant demonstrable economic harm to end use customers or other non-parties. Such harms, if shown, would need to be balanced against any adverse effects of contract abrogation on wholesale competition, infrastructure investment or long-term reliability of supply and delivery.

Staff has not finished reviewing the records in E-21, -23, and -24 but our review to date indicates that

none of the complainants in these cases has met the public interest standard of review. Accordingly, our recommendation at this time would be to deny the complaints. Thank you.

CHAIRMAN WOOD: Nora?

COMMISSIONER BROWNELL: This is not an easy day. The Puget Sound Nevada Power CPUC cases all present a common issue, whether in fact it is appropriate for this Commission to abrogate contracts in light of the dysfunctions of the western spot power markets during 2000 and 2001. The Puget case involved bilateral spot power purchases in the Pacific Northwest, predominantly under the WSPP umbrella agreement. The other cases involved forward purchases for longer periods under either the WSPP agreement, the EEI master agreement or the other bilateral contracts.

The WSPP is the largest electric trading organization in North America with nearly 250 members, 23 percent of which are IOUs, 32 percent of which are publics, and 44 percent of which are marketers and the remainder are IPPs. The WSPP agreement effectively serves as the market form for the Pacific Northwest. It is the most heavily used sales contract for physical delivery in the industry.

WSPP agreement provides standardized products, terms and conditions but also provides parties in any given transaction, the ability to individualize contract terms.

THe issue of how to weight contract sanctity in the context of the western power crisis is, to say the least, a very difficult one. And we have all spent many sleepless nights pondering it.

I have been clear in my prior statements about the belief in the sanctity of contracts and I've stated previously that I believe the judicial precedent on the Mobil Sierra Doctrine warrants applying the public interest standards to contract abrogation unless there is specific language in the contract that invites the Commission to apply a lower standard.

Three Administrative Law Judges assigned to these cases have all unequivocally agreed. Therefore the question in these cases now is not whether the contract rates are unjust and unreasonably high but whether the public interest standard demands that they be changed, and I struggle with this question. How can it be, how can we answer the question? How can it be that contract rates that are considerably higher than prevailing prices due either to dysfunction or manipulation be in the public interest. It's a very difficult question and one that on its face appears easily answered. Of course they can't be.

After all, it's our nature to want to pay the lowest price we feel like we bargained well and we got the best deal. However, price alone cannot be the only

consideration. Rather I believe we should measure the entirety of the contract, the totality of the circumstances, and whether the benefits of unwinding the deal exceed the costs of doing so.

For me, the sanctity of contracts is not some dry, legal doctrine foisted upon the Commission by the Supreme Court. Bilateral contracts entered into by buyers and sellers, in an effort to manage supply and price risk, serve as the basis of today's wholesale power markets. Indeed, they are the very basis of our economic system in this country.

Parties to these contracts on an on-going basis are making decisions to buy and sell power, and use all the information available to them. Parties to contracts follow the risk management practices of their companies. Bilateral contracts form the basis for infrastructure investment and needed generation and transmission facilities vital to the reliability of the nation's power system. Investors simply will not participate in a market in which disgruntled buyers are allowed to break their contracts, at least without charging a significant risk premium, a premium I believe that we've seen in some of the marketplaces and a cost that ultimately is borne by customers.

A trial has been held in each one of these four cases so although we are still uncovering new information

about the causes of the crisis, we already have a wealth of information about these contracts. Under normal circumstances, given complainant's failure to demonstrate that any of the contracts would have a tangible adverse effect on ratepayers or would significantly undermine their own financial health, I would not abrogate any of these contracts. In fact, the evidence presented in these cases demonstrates the contrary.

The Nevada Companies admit that the contract prices were at or below prevailing market prices, evidence does not show an excessive burden on consumers.

To the contrary, evidence shows that the Nevada Companies' projections assumed that they would file for a rate decrease in excess of 20 percent in November 2002 in their rate case.

The associated cases I think show similar degrees of circumstances, and I'm referring to Southern California Water Company and Tacoma. I do think that we need to look at principles when we are looking at this. First, I'm influenced to the extent to which the complainants in different cases were acting to meet the immediate needs of their native load.

For example, in the Puget Sound case, other like California IOUs, buyers in the Pacific Northwest were not required to buy all of their power in the spot market.

For example, over 99 percent of the City of Seattle's new purchases net purchases from December 2000 to 2001 were made under forward contracts. Nevertheless, regardless of whether the Pacific Northwest buyers should have put themselves in a position of relying on the spot market. To the extent they did, they were forced to either pay the dysfunctional prices or let the lights to out.

In contrast, buyers of forward longer term power did not face such a Hobson's choice. Second, I am influenced by the timeliness of the different complaints. This Commission has said that in a market-based rate world, if a buyer believes he is dealing with a seller with market power, he should not go ahead and sign a contract with that seller, sit on his rights, and then file a complaint later to try to get the contract changed. Rather he should file a complaint before or simultaneously with the execution of the contract.

In the Puget case, which I believe is the exception, the parties acted exactly as we had advised them to. Puget filed its complaint in December 2000 and most intervenors intervened within weeks of the complaint.

In contrast, the other complainants in other cases went ahead, signed contracts and then waited weeks or even months before filing complaints.

Third, I am influenced by the strength of the

connection in the northwest with the California Power Market. The extraordinary circumstances that lead me to even consider contract abrogation in these cases is the meltdown in the California spot market. Few would question the link between the California spot market and the Pacific Northwest spot market.

In contrast, I believe there is very mixed evidence of the linkage between spot markets and forward markets. Our staff report concluded there was a significant linkage. There are many, many other studies that disclaim such a linkage.

What happens today does influence what happens tomorrow, but I think that type of linkage falls short of a causal relationship. The market participants that signed contracts were experienced players who knew what weight to put on spot market events when they decided to enter into long-term contracts. Also, the long-term contracts, by definition, reflect what the buyer and seller expect the market to look like in the future when those contracts will come to delivery, not dysfunctions in the spot market.

Moreover, in the spot market the immediacy of serving load markedly distinguished the decisionmaking about entering contracts and the factors that are considered in entering into long-term contracts.

More importantly, this issue was squarely before

the other ALJ in the Nevada hearing, two studies taking the opposite position were presented and subject to extensive cross examination and I believe the Judge concluded that the studies done by Doctors Hogan, Harvey and Professor Kalt were given substantial weight because they had run significantly more sensitivity tests and modeling to support their conclusions.

I am influenced fourth by the Commission's jurisdiction of oversellers outside the California spot markets. The Commission has asserted jurisdiction over normally non-jurisdictional sellers, a tough question I admit, Bill, in the California spot markets based on arguments about the special nature of the organized ISO and PX markets.

Whether these arguments will prevail in court only time will tell, but the Commission has concluded that such arguments are not available to extend jurisdiction over governmental entities outside the California ISO and PX markets.

The Washington and Oregon Commissions, interestingly enough, questioned whether it is equitable to order refunds, given that many of the sellers are not jurisdictional. They expressed concern that under these circumstances, refunds would be discriminatory and disruptive of orderly regulation.

In the longer-term contract cases, complainants were both buyers and sellers in a daisy chain of transactions. The record indicates that power changes hands six times from the point of generation until the last purchaser in the chain. Any attempt to start unwinding non-spot markets in the west will result in public utilities bearing an unfair burden.

Finally, I am influenced by the record influence in these cases. Even if there were manipulation, equities do not support abrogating the specific contracts. By that I mean Nevada and the associated contracts with Nevada.

The exception I would make is that I would certainly not accept the CPUC, where I think the same arguments hold true. The only exception I would consider would be the 30-day and under contracts that I think defined the spot market in the Puget Sound case. I'd like Staff to comment about how we might go about dealing with process that would evaluate that further.

MR. BARDEE: For the Puget Sound case, Commissioner, if the Commission would conclude that the public interest standard of review had been met in that case, the Commission would then be required to set the just and reasonable rate for those arrangements, those contracts.

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There would be possibly two ways to go about that: One would be to have a further process directly with the Commission, meaning the Commission could seek comment from the parties in the case on how it should set the just and reasonable rate.

Then the Commission could make its decision. The other alternative that comes to mind would be to remand the proceeding to the Administrative Law Judge to conduct a

similar determination and make a recommendation to the Commission.

Then there would be briefing on exceptions and opposing, and it would be back with the Commission.

COMMISSIONER BROWNELL: I'm open to the process. I think that in the interest of equity, I was persuaded by the Puget Sound timeliness and some of the arguments, as I am unpersuaded to consider abrogating any of the other contracts, although we have Pacificorp coming up in the next round.

I'd like to move forward, if my colleagues agree that we should even consider looking at the Puget Sound case, to move forward expeditiously so that once again, we can bring resolution.

COMMISSIONER MASSEY: With respect to the spot prices in the Pacific Northwest, which we would define as 30 days or less, I think I agree with Commissioner Brownell that we should take a look at those prices, and I would support any reasonable procedures to do that, any reasonable Staff recommendations about how to do it.

Let me say -- should we just talk about that for a minute, that aspect of it? Talk about all of it? All right.

I've struggled with the standard of review that we should apply whenever these cases were sent to hearing.

I often wrote a separate statement saying that I thought it was our solemn responsibility under the Federal Power Act, as I read it, to ensure just and reasonable prices all the time.

That doesn't just mean in spot markets. That means long-term contract markets as well. There is no exemption for those markets in the Federal Power Act.

A market is a market. A contract is a contract, whether it's short-term, long-term, or whatever.

I'm aware of the complexity of the Mobil and Sierra cases. There is a very thoughtful debate among the three of us about how to apply those somewhat murky standards, and we may not reach the same point.

I must say that I was persuaded by the findings in the Gelinas report, which echoed what just makes common sense to me, which is that there is a very sharp correlation between spot market prices and long-term contract prices that are negotiated in the same timeframe.

I put myself in the position of the market participants out West. The spot prices were raging out of control.

The Commission had declared them to be unjust and unreasonable, yet the Commission had not at that point, taken the kind of firm steps that were necessary to ensure that the prices were just and reasonable.

And it was unclear to the market participants, what the Commission would do, ultimately. It was hard to predict.

Would the Commission allow these prices to rage on? I remember that the Commission issued an Order in February of 2001 that's emblazoned in my memory. I dissented on it, but the Commission said -- this was at the height of the crisis -- the Commission said that any bid into the California market that's $430 per megawatt hour or less, we're not going to take a look at, the implication being that it's probably just and reasonable.

So if I were a market participant out there seeing that and I could negotiate a long-term contract for a buyer, I could negotiate for $200, $250 not knowing how long these $430 or $500 prices or $700 prices would continue.

Wasn't that a reasonable thing for me to do? I think the answer is yes. That doesn't make those prices just and reasonable in that contract.

If the spot market prices were unjust and unreasonable, the Gelinas report finds there's a strong correlation between those prices and the impact on long-term contract prices, which just makes common sense. In fact, in our standard market design NOPR, not specific to the West, but we point out that correlation.

One of the reasons we propose a well functioning

spot market is because we understand, as a federal agency, that a well functioning spot market is literally the centerpiece of a long-term contract market, because that's what market participants look to, among other things. It's not the exclusive thing, but it's a very important thing.

So all those factors are swirling around in my brain, and I'm wondering what to do about this.

On the one hand, I have Mr. Bardee's comment and the Staff recommendation that setting aside these long-term contracts is not recommended; that it will have a dramatic impact on the future of competitive markets, if market participants don't believe that they can rely on long-term contracts. I respect that point of view.

Here is my question: What is going to be the future of competitive markets if market participants don't believe this Commission will step in to reform long-term contracts that are unjust and unreasonable? Isn't that a foundation for competitive markets as well?

So I could argue that the future of competitive markets actually depends upon market participants having faith. If we're going to have markets, this Agency will monitor them, oversee them, and if they rage out of control, we will step in. We will ensure that prices are just and reasonable all the time.

And that weighs on me, that counterbalancing

factor. We're in the difficult position here because the Mobil and Sierra doctrines arose in a cost-based system. They didn't arise in a market-based system.

In a sense, the factors that you take into account in determining whether you're going to respect a contract in a cost-based system, may be sharply different from the factors you take into account in determining whether an unjust and unreasonable contract is nonetheless respected in a market-based system.

You're probably utterly confused about what I'm going to do.

(Laughter.)

COMMISSIONER MASSEY: But let me say that I believe -- and I'm still looking at the facts of all of these cases -- but I am persuaded by the Gelinas report that there was a correlation between spot prices, certainly a correlation, as Commissioner Brownell points out, spot-to-spot. Spot in California certainly influenced spot in the Pacific Northwest.

I think spot in California influenced -- strongly influenced long-term contract prices, and I believe I'm going to come down on the side of remedying that, and I don't know whether I'll apply the just and reasonable standard, or the public interest standard, but I believe that the public interest is well served by this Commission

insisting that markets produce not only just and reasonable spot prices, mid-term prices, but also long-term prices.

I think markets need to believe that if that's not going to be produced, that this Agency will step in and remedy it, otherwise, nobody is going to want to have markets for electricity.

That's the way I feel about it. So those are the issues I'm going to take into account, as we finalize these cases.

CHAIRMAN WOOD: Bill, do you have any thoughts on the Puget issue?

COMMISSIONER MASSEY: I agree with Commissioner Brownell on the Puget issue.

CHAIRMAN WOOD: This is why I get to go last. I think, largely, I am more consonant, Nora, with your view than with Bill's on this more broadly. I would like to lay out publicly how I get there.

I think the standard of review is important. We've laid out for ourselves, in the Mobil-Sierra policy statement, which had a lot of actually very helpful timely feedback on this issue as we have been grappling with it, really for the better part of the last almost year, since last April when we sent the Nevada SCWC and Snohomish complaints over.

We asked -- I think there were a handful of the

CDWR cases and maybe the Snohomish contract, yes, as well, that had actual explicit language along the lines that we had talked about being truly the public interest language that the parties put in there.

But the balance of the contracts did not have that language, so we asked the judges to look at really what is the intent of the parties as to what the standard of review should be, and I respect their conclusions that, at least as to the cases we have so far, that the public interest standard is applicable.

Then that gets us to the question of what is the public interest standard? I would just lay out, as I mentioned to you all individually, but lay out certainly the three that are traditional in case law, which are the effect on the utility, the effect on its customers, and whether there is any undue discrimination.

Clearly, those are there, and in this case, I guess, as I would think you both have pointed out, clearly the focus when it's a seller -- I mean, a buyer wishing to reform the contract, and he's a wholesale customer, that you look to the customers, the ultimate, end-use customers for that analysis.

Also, in balancing the public interest, I'm also mindful, I think, Bill, of an issue you raised back when we put out the policy statement. Did you basically have to

agree to a Mobil-Sierra cause? Was it under some sort of duress that you had to put that in there?

But, more broadly, was there kind of the economic duress? I think you've covered that, certainly, in your thoughts on that as well.

And then a fifth item that is particularly unique here in light of what we asked our Staff to do, and which they reported on in the Staff report, Chapter 5, that we've all read countless times, that there is a correlation between the spot market and, in particular, the shorter of the long-term contracts, the one- to two-year contracts.

That certainly is a fifth prong if those contracts are, indeed, that short, and there are a handful here that are. So, to me, those come in the door with me to look at then what are the totality of the circumstances here, in pondering whether to abrogate or revise these contracts.

Some have four standards, in my mind, that I look at to balance the public interest. Those shorter ones, in light of the Gelinas report, have five.

We wisely, when we referred these complaints to hearing back in April -- and I believe the DWR contracts in May or June -- asked for the Judge and the parties to develop a record for the totality of the circumstances.

How big a part of your overall portfolio is this

contract? Are these contracts?

I think your point, Nora, was a good one, when you filed, how long was that since the time since you entered into the contract? Is it buyer's remorse within the period or not?

What are the implications for the price of this contract for the balance of your portfolio? What are the implications of it for your customers? What are the implications of it for yourself? What were the contemporaneous circumstances that surrounded the negotiation? Were there other offers made where you kind of stuck with take-it-or-leave-it and no one else in line?

These factors, to me, are pretty difficult to put a quantification next to. But, in my mind, particularly the shorter-term contracts, in the Nevada case, in particular, the Nevada and Sierra contracts, the totality of the circumstances there: Why did you buy this power; what did you use it for; did you buy more than you needed, less than you needed?

In this weighing of the issues, I cannot get to a point, based on what I've seen -- and I've seen a lot of this in this particular case -- I cannot, in weighing that totality there, determine that the contracts should be reformed or abrogated. I think even considering probably that very big issue about the linkage between the spot

market and the long-term market, that was raised in the Staff's proceeding, that does not offset the other factors in weighing the public interest that would urge me to abrogate these contracts.

So that's where I am on those today. I know we do have more evidence to review in the 100-day discovery, and I'm fine with that, but we spent a lot of time on this, and I do appreciate that we all come at it from different history and different perspectives, but I have to say here I do think that having these contracts be maintained where they are is appropriate, is consistent with the law, and consistent with the record that has been developed for us.

I'm intrigued, and I agree with the differentiation on Puget. I think to kind of clarify why, and I think this is what you said, Nora, but I just want to make sure, if as we know these markets in the West are interrelated, we allow for the spot market remedies in the California market to be done, it is really, to use the appropriate phrase, in the public interest for us to allow that same remedy to occur in the adjacent market.

Certainly there was a timely complaint filed based on the fact that they established on Christmas day of 2000. It is a tortured history, though. Actually, last night that was before I read -- I did sleep actually after reading it, but I did read the comments about the intervening parties, and it is a mess. I do hope we can get a process in place that can allow these parties to really look at this in the calm light of at least a little bit of delay from when they filed the complaint, and think that this is the way to go forward.

I do think I agree with you, Nora, I can say that the weighing of the factors on the WSCC contract that we're talking about which prevailed in that market as really a substitute for what the ISO PX markets were doing in California, they are contractual. They do have language that says parties may jointly file a 205, and is silent for 206. I think the legal interpretation, and I'm not going to

embarrass the church with my bad Latin, but if you include one thing, then the exclusion of the companion thing is assumed. I think that is a well versed standard that I have certainly voted on in my prior job several times.

But I do think the WSPP contract is one that, as the judges have analyzed, does raise it to a public interest review. I do think for the reasons you laid forth, Nora, and maybe any that I've added, that that is a hurdle that has been met and should be met here to allow for the 30-day or less contracts, which are really the equivalent of the spot market outside of California to be subject to prospective from the day of refund mitigation.

I do think the biggest problem for me is the nonjurisdictionals. You can't daisy chain back very far in any of these sales before you hit a brick wall. That is really beyond our jurisdictional reach. I do think it is in the public interest and legal and correct to allow that complaint, to grant the rehearing on the complaint, and to instigate today moving from December 25th forward to when we put in the mitigation. But I do strongly think that we need to find a forum where these parties can all look each other in the eye and say do we really want to go here. They have a right to do it. I would say in my mind, that's a good one.

And I think one of the parties said this in the

pleadings. You do have a right to do it. I just wish you wouldn't, because it's a mess. I am guided actually by the state commissions there as well that look at it from the broader interest. But I do want to get the process set up and then set it up certainly if there's a settlement opportunity or if there's some opportunity for us to hear back from parties before we can jump back into the spiral.

So with that throwing off of thoughts, I'm done.

COMMISSIONER BROWNELL: Actually, I think the concept of settlement is a good one. This was a big stretch for me, knowing as you all do my feelings about the sanctity of contracts. These were truly a unique, one-time-only set of circumstances I think that would lead us there. But I think it is a very complicated story. I think you have people, the very people complaining who were selling in the marketplace at $1,100, I think you had some people who were complaining who actually had pretty good contracts where the seller was taking the risk the first couple of years.

I think people should look in the mirror. And what I would do is rush to settlement. I would offer the services of a settlement judge if my colleagues agreed, because I think this is part of a very, very ugly picture in the West where I don't think frankly anyone is on the side of the angels.

Bill, I appreciate your thoughts. This has been

agony in many ways. But to answer your question about what gives people confidence in the marketplace, I think these things give people confidence in the marketplace. I think that we say as we did following the Gelinas report, we're going to take the following actions to make sure the rules are right, because the rules aren't right. And we're going to take actions to act promptly to deal with issues as they come up in the marketplace. Because market gets responsive very quickly. They respond dysfunctionally, but they respond. They don't wait for us or our departments to hang around and do something.

So the first thing is we need to get the rules right. The second thing is we need to respond quickly. And I think the third thing is something you referred to in your opening remarks. I don't think we can let ourselves under any circumstance get bulldozed into approving market designs or market structures that we know inherently are destined to failure the moment some other anomaly in the market like scarcity or whatever occurs.

I would hope that not abrogating these contracts does not in fact cause people to lose confidence in the opportunities in long-term markets. On the contrary, I would hope for the opposite effect. But they are responsibilities we have. I know we all take them seriously, but those are the answers.

COMMISSIONER MASSEY: We're just having a fairly robust debate here on this issue. I believe that you and Pat very much want to do the right thing here for the markets, for consumers, for sellers, for everyone. I understand that. I really respect the way you're coming at it. Your statements from both of you are very thoughtful. And I appreciate that.

Let me ask a question. Did any of us discuss where the market manipulation question fits into the contract debate?

CHAIRMAN WOOD: I did. I went at it as one of the public interest factors where they identified shorter term contracts.

COMMISSIONER MASSEY: But what about for longer term? Are we still weighing that? It is something I would weigh. I'll just say that. I think it's relevant. It's something I overlooked when I was explaining my views on this.

So where do we go from here, Mr. Chairman?

CHAIRMAN WOOD: I think the Puget deal is going to certainly on some of the details, there was a lot in Judge Cintron's initial -- or it wasn't exactly initial decision, was it? Preliminary something.

MS. MARLETTE: Proposed findings.

CHAIRMAN WOOD: That I found pretty persuasive.

The actual caption of the complaint has to be observed, since even though the petitioner ultimately asked to withdraw his own complaint, which we're now denying, it was captioned to be within the Pacific Northwest sales to customers in the Pacific Northwest.

I think that has to be a constraint. I know some other parties tried to make it more of a Westwide issue, but I don't think that's what it was, despite what folks may want it to be.

The 30-day definition of the spot, I know some actually argue that it should be lower than that, but in fact it's not that long. I do think the dominant balance in the proceeding though is that it was a 30-day or less type market that people used to procure their kind of incremental or decremental supplies or to sell those, and seemed to be pretty much from Bonneville on down a broad consensus that that was the appropriate definition of the spot. And I think what in my mind I want to do is equate the timely remedy there to what we had done in California.

So it's the spot market in California. It's the spot market in PNW. So even though they look different, I think what we're after is trying to get the spot market. There are some issues about exchanges and sleeves. I think the judge had made a conclusion that those should not be considered. I think the rationale there was certainly

pretty strong.

COMMISSIONER BROWNELL: No ripple claims, no sleeves.

CHAIRMAN WOOD: Just look at the ultimate sale from the consumer buyer to his prior seller and look at those transactions. That would be my thought, to get up an order at that. And I think the process would be -- what would we want to do, go ahead and send it to a settlement judge? I asked parties to brief what would be the appropriate day to set a J&R rate for that period of time. That would be in the order.

COMMISSIONER MASSEY: I heard Nora suggesting that we send it to a judge. Were you?

COMMISSIONER BROWNELL: The first step is to offer the services of a settlement judge for a very, very limited period of time, then I'd say let parties brief, and we'll make the cut rather than send it for another year's worth.

I mean, I would say to the parties, this is not the 17th bite at the apple. We have a lot of facts here. And as I said, some not so pretty for anybody. So I think people really ought to focus on the issues at hand and get resolution. Because as we've said, you know, resolution is what we're after. Equity, certainly. But let's be disciplined about this. First and foremost I would hope

that the parties would settle.

CHAIRMAN WOOD: So we would need to make our Mobil Sierra discussion finding as to why these would be opened and go through an analysis which we're going to probably need to think about and talk about.

Similarly in the other cases, although the outcome appears to be going the other way, I think we need to lay out our analysis on that and bring those up at a future meeting next month.

MS. MARLETTE: We will work on orders on all three of those cases.

CHAIRMAN WOOD: Right.

COMMISSIONER MASSEY: Yes.

CHAIRMAN WOOD: Thank you, Staff. I know this has been a busy month, but everything here is important. Thanks to you all for doing what you're doing. And I want to say I know our judges who performed this analysis in a real short period of time are here. I want to thank you all, Judge Cintron and McCartney for your efforts. Where is Judge Birchman? I've already tipped my hat to him. There he is. Ditto.

Okay, folks. Long day, and I appreciate the hard work. Meeting adjourned.

(Whereupon, at 1:45 p.m. on Wednesday, March 26, 2003, the meeting adjourned.)